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Multistate Tax
EXTERNAL ALERT

Ohio Enacts Municipal Tax Reform

December 19, 2014

Overview

On December 19, 2014, Ohio Governor Kasich signed Substitute House Bill No. 5 ("H.B. 5"),[1] which creates uniform provisions applicable to Ohio municipal income tax regimes (municipal net profits tax). To address specific nuances in general income tax calculation and filing procedures among the more than 600 municipalities, the bill applies uniform standards in the following areas:

- Taxation of pass-through entities
- Net operating loss carryforwards
- Consolidated corporate returns
- Withholding for nonresident employees
- Various procedural items

In this Tax Alert we summarize the significant law changes contained in H.B. 5 that impact businesses. Unless otherwise specified in the discussion that follows, these changes are effective January 1, 2016.[2]

Pass-through Entity Treatment (Partnerships, S-Corporations and Limited Liability Companies)

Current law provides an option for municipalities to tax either the pass-through entity or its owners (on their respective distributive shares of income). H.B. 5 provides that the municipal net profits tax shall be imposed on pass-through entities at the entity level. However, under H.B. 5, municipalities may continue to tax the income that passes through to a resident individual owner under applicable uniform rules.[3] If the owner is a nonresident individual, the owner will not be taxed by a municipality on his or her share of pass-through income.[4] Also, under H.B. 5, the taxation of S-Corporations and their resident shareholders will not change from current law.[5]

Net Operating Loss Carryforward

H.B. 5 brings uniformity to Ohio municipal net operating loss ("NOL") carryforward provisions. Currently, 260 municipalities, including Columbus and its suburbs, do not allow for NOL carryforwards, while some municipalities permit a five-year carryforward and others offer varying lengths of carryforward. Under H.B. 5, for the jurisdictions that are *not currently permitting* NOL carryforwards, the amount of NOLs incurred for taxable years beginning after 2016 may be deducted to offset up to 50% of income generated in taxable years beginning in 2018 to 2022, and up to 100% thereafter. For the jurisdictions *that currently allow* NOL carryforwards, the NOLs accumulated for periods prior to 2017 will be treated as deducted "first" and without the 50% limitation during the 2018 – 2022 phase-in period.[6]

[1] H.B. 5, 130th Gen. Assemb., Reg. Sess. (Ohio Dec. 19, 2014). A copy of the adopted law is accessible at: **http://www.legislature.state.oh.us/bills.cfm?ID=130_HB_5.**
[2] Substitute H.B. 5, amending Ohio Revised Code ("ORC") § 718.04.
[3] Substitute H.B. 5, amending ORC § 718.01(B)(1)(a).
[4] Substitute H.B. 5, amending ORC § 718.01(B)(2).
[5] *See*, ORC § 718.01(H)(9)(a), in which the language was unchanged by Substitute H.B. 5, though the provision was moved to become amended ORC § 718.01(C)(14). This statute provides that a municipal corporation is to tax the S corporation itself and cannot tax the S corporation shareholder's distributive share of the non-wage net profits of the entity, unless the municipal corporation's taxation of this income was grandfathered in under prior legislation. Reform was enacted in 2002 and 2004, which provided that only those municipalities that were already taxing an S corporation shareholder's distributive share of non-wage S corporation profits were permitted to do so in 2004 and forward.
[6] Substitute H.B. 5, amending ORC § 718.01(E)(8).

Consolidated Returns

Ohio municipalities have generally permitted corporate consolidated filings when an affiliated business grouping filed a consolidated federal income tax return. The new law provides more detailed guidance on consolidated filings and potentially permits corporate entities to elect to de-consolidate.

Under H.B. 5, the "default" filing methodology follows the federal consolidated income tax treatment.[7] If an affiliated group of corporations files a consolidated municipal return, the consolidated filing election is treated under H.B. 5 as a binding election to file consolidated for the following five years. The consolidated filing election is automatically renewed (for a five-year term) until the corporate group receives permission from the municipal tax administrator to de-consolidate or makes a new election to file separately after the final consolidated year. Also, the taxpayer must notify the tax administrator prior to filing an amended consolidated return and prior to amending its return from separate to consolidated.[8]

As in the case of a consolidated election, a request to terminate that election (*i.e.*, to make a new election to file separately) is binding for five years, and all members of the affiliated group must adhere. A tax administrator may require a consolidated filing if the taxpayer is a member of an affiliated group that filed a consolidated federal income tax return and the tax administrator determines that: (1) there is a preponderance of evidence of distortive shifting of net profits to/from the municipality; and (2) the intercompany transactions have not been conducted at arm's length.[9]

H.B. 5 also provides an option available to consolidated groups to include or exclude an 80% or more owned pass-through entity's income and apportionment factors from the consolidated tax return. If excluded, the pass-through entity may still be subject to the municipal net profits tax at the entity level.[10] Income and apportionment factors from pass-through entities that are less than 80% owned must be excluded.[11]

Occasional Entrant Withholding Exemption

Municipal income tax withholding on employee wages is required. However, under current law an employer is not required to withhold municipal income tax if the employee performed services in the municipality on 12 or fewer days in a calendar year, unless certain conditions apply.[12] Under H.B. 5, an employer is not required to withhold if the employee performed services in the municipality on 20 or fewer days in a calendar year, unless certain enumerated conditions apply.[13]

Due Date, Minimum Payment Threshold, Estimated Tax and Statute of Limitations Uniformity

Under current law, municipalities have discretion to reasonably determine annual income tax return due dates, provided that the original due dates are not earlier than the comparable federal return due date. H.B. 5 establishes uniformity by requiring that annual municipal income tax returns are due three and a half months after the close of the taxpayer's tax year.[14] Extended municipal returns are due nine and a half months after the taxpayer's tax year end. An automatic federal extension is treated as an automatic municipal extension. The return filing extension does not change the date upon which tax is due.[15]

H.B. 5 adopts a new minimum payment threshold of $10 for municipal jurisdiction income tax remittances.[16] Similarly, the municipalities are not required to issue refunds of less than $10.[17] The minimum remittance requirement does not negate the municipal return filing requirement.[18]

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[7] Substitute H.B. 5, amending ORC § 718.06(B).
[8] Substitute H.B. 5, amending ORC § 718.41(A).
[9] Substitute H.B. 5, amending ORC § 718.06(C).
[10] Substitute H.B. 5, amending ORC § 718.06(E)(3).
[11] Substitute H.B. 5, amending ORC § 718.06(E)(4)(a).
[12] *See*, ORC § 718.011, which provides for municipal withholding to commence on a go-forward basis on the employee's 13th day in the jurisdiction.
[13] Substitute H.B. 5, amending ORC § 718.011(B). *See*, ORC § 718.011(B)(1)(a)-(d) for the conditions that would prevent the application of the withholding exemption.
[14] Substitute H.B. 5, amending ORC § 718.05(G)(1).
[15] Substitute H.B. 5, amending ORC § 718.05(G)(2).
[16] Substitute H.B. 5, amending ORC § 718.05(H)(1).
[17] Substitute H.B. 5, amending ORC § 718.19(A)(1).
[18] Substitute H.B. 5, amending ORC § 718.05(H)(2).

Under H.B. 5, municipalities will collect estimated taxes from taxpayers whose estimated tax liability (after consideration of withholding) is greater than $200.[19] The new law also adopts a "safe-harbor" provision that negates application of an underpayment of estimated tax penalty if a taxpayer has remitted 90% of the current year tax in accordance with the estimated payment dates.[20]

H.B. 5 establishes a uniform three-year statute of limitations period that applies absent issues of fraud, a failure to file returns or a significant reportable income omission. Taxpayers may seek municipal tax refunds within three years of the later of when the original tax was due or when such tax was paid.[21] Similarly, the municipality's tax administrator has three years from the later of the tax due date or the date the tax return was filed to bring civil actions to collect municipal income taxes. A potentially longer assessment statute of limitations exists if the taxpayer contests a finding that unpaid taxes are due by filing an appeal with the applicable local tax review board.[22]

Contacts

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[19] Substitute H.B. 5, amending ORC § 718.08(B)(1).
[20] Substitute H.B. 5, amending ORC § 718.08(C). Note that 22.5%, 45%, 67.5% and 90% of the business taxpayer's estimated tax liability is to be remitted by the fifteenth day of the fourth, sixth, ninth, and twelfth months of the fiscal year, respectively. Individual taxpayers have estimated due dates of April 30, July 31, October 31 and January 31.
[21] Substitute H.B. 5, amending ORC § 718.12(C) and § 718.19(B).
[22] Substitute H.B. 5, amending ORC § 718.12(A).